FILED

No. 97-446 SEP 11 1997

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In The

Supreme Court of the United States

October Term, 1996

DAVID MARGEN AND LAWTON ASSOCIATES,

Cross-Petitioners,

v.

TEVIS T. THOMPSON, JR., TRUSTEE IN BANKRUPTCY FOR JAMES DELBERT McCONVILLE AND CLARA MAE McCONVILLE,

Cross-Respondent.

Conditional Cross-Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI

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16 pp

QUESTIONS PRESENTED

The Petition for Certiorari in Case No. 97-271 filed by Cross-Respondent Tevis T. Thompson, Jr. should be denied for the reasons set forth in Cross-Petitioners' "Brief in Opposition" filed concurrently herewith to Cross-Respondent's Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit. If this Court were to grant the Petition in Case No. 97-271, however, this Court should also consider the following, closely related questions:

1. Is a purchase money secured lender, who receives and records a deed of trust in good faith, without knowledge of the debtor's bankruptcy case, and for fair equivalent value, entitled to the protection of Bankruptcy Code section 549(c), 11 U.S.C. § 549(c)?

2. Does the creation and recordation of a deed of trust contemporaneously with the transfer of title to the debtor constitute "a transfer of property of the estate" subject to avoidance under Bankruptcy Code section 549(a), 11 U.S.C. § 549(a)?

3. Is a purchase money secured lender who advances funds in good faith and without knowledge of the debtor's bankruptcy case entitled to an equitable lien to secure the moneys it advanced and reasonable interest thereon?

LIST OF INTERESTED PARTIES (SUPREME COURT RULES 14(b) AND 29.6)

Cross-Petitioner David Margen and Cross-Respondent Tevis T. Thompson, Jr. are individuals. Mr. Thompson is a party to this matter in his capacity as trustee of the chapter 7 estate of James Delbert and Clara Mae McConville, individuals.

Cross-Petitioner Lawton Associates is a California general partnership. Its partners are Susan V. Smartt, Louis J. Lovotti, Ronald J. Kriss, and Susan Peck. Lawton Associates has not issued shares to the public, and it is not a parent, subsidiary, or affiliate of any company that has issued shares to the public.

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I.

JURISDICTION

On March 26, 1997, the United States Court of Appeals for the Ninth Circuit entered its order and opinion from which Cross-Petitioners conditionally seek review. The Ninth Circuit thereafter denied Cross-Respondent's petition for rehearing on May 27, 1997. Cross-Respondent timely filed a Petition for Certiorari in Case No. 97-271, which was docketed by this Court on August 12, 1997. Pursuant to Supreme Court Rule 12.5, this Conditional Cross-Petition is being timely filed within 30 days of the filing of the Petition for Certiorari in Case No. 97-271. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).[1]

II.

STATUTES INVOLVED IN THIS CASE

11 U.S.C. § 549. Postpetition Transactions.

> (a) Except as provided in subsections (b) or (c) of this section, the trustee may avoid a transfer of property of the estate –
>
> (1) made after the commencement of the case; and
>
> [(2)(B)] that is not authorized under this title or by the court.

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[1] The decisions of the lower courts are reproduced in the Appendix to the Petition in Case No. 97-271, and are thus not included in this Cross-Petition. *See* Supreme Court Rule 12.5.

* * *

(c) The trustee may not avoid under subsection (a) of this section a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected.

11 U.S.C. § 101. Definitions.

In this title –

* * *

(43) "purchaser" means transferee of a voluntary transfer, and includes immediate or mediate transferee of such a transferee;

* * *

(54) "transfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosing of the debtor's equity of redemption[.]

11 U.S.C. § 364. Obtaining Credit.

* * *

(b) The court, after notice and a hearing, may authorize the trustee to obtain unsecured credit or to incur unsecured debt . . . , allowable under section 503(b)(1) of this title as an administrative expense.

(c) If the trustee is unable to obtain unsecured credit allowable under section 503(b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt –

(1) with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title;

(2) secured by a lien on property of the estate that is not otherwise subject to a lien; or

(3) secured by a junior lien on property of the estate that is subject to a lien.

III.

STATEMENT OF THE CASE

Cross-Petitioners David Margen and Lawton Associates believe that no basis exists for this Court to grant certiorari in this case. However, Cross-Petitioners are filing this Conditional Cross-Petition for Certiorari out of an abundance of caution to preserve their rights to assert certain defenses and to seek the payment of interest were this Court to grant the Petition for Certiorari in Case No. 97-271.

Cross-Petitioners fully incorporate the Statement of the Case included in their "Brief in Opposition" (the "Certiorari Opposition") to Cross-Respondent's Petition for a Writ of Certiorari in Case No. 97-271. The factual and procedural basis for this Conditional Cross-Petition is the same as for the Certiorari Opposition.

IV.

SUMMARY OF THE REASONS FOR GRANTING THE CONDITIONAL CROSS-PETITION IF CERTIORARI IS GRANTED IN CASE NO. 97-271

This case clearly does not satisfy the criteria this Court routinely applies when considering whether to grant certiorari. The Ninth Circuit's decision does not establish any new precedent, but rather faithfully applies well established equitable doctrines to the unique facts of this case. Moreover, no direct conflicts of authority are implicated by the decision. The Ninth Circuit's decision is correct as a matter of law, equity, and common sense. Accordingly, this Court should deny the Petition in Case No. 97-271. Nevertheless, if the Court were to grant the Petition in Case No. 97-271, it should also grant this Conditional Cross-Petition.

The Petition asks that this Court consider the applicability of Bankruptcy Code section 549(a)[2] to a secured lending transaction. The Petition completely ignores, however, any discussion of Cross-Petitioners' defenses to Bankruptcy Code section 549(a), including:

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[2] All references herein to the "Bankruptcy Code" are to title 11 of the United States Code, 11 U.S.C. § ___.

(i) Bankruptcy Code section 549(c), which protects parties that act in good faith and without knowledge of the bankruptcy case,

(ii) the applicability of this Court's decision in *Farrey v. Sanderfoot*, 500 U.S. 291, 111 S. Ct. 1825 (1991), which precludes the avoidance of a lien that attached simultaneously with the debtor's acquisition of the encumbered property, and

(iii) Cross-Petitioners' right to a lien in an amount equal to the value Cross-Petitioners provided to Debtors' estate.

These issues are integral, not just to the application of section 549(a) in this case, but to the interpretation of section 549 generally.

This Court should not consider the issues raised in Case No. 97-271 at all. If the Court does grant certiorari, however, it certainly should not consider Case No. 97-271 in a vacuum. To do so would not only cause an injustice to Cross-Petitioners, but would also create the anomaly of a Supreme Court decision that ignores the interrelationships of a comprehensive statutory scheme. Cross-Respondent should not be allowed to narrow the scope of review artificially by selectively picking only those issues that it believes to be favorable to its position, to the exclusion of other issues that are integral to the resolution of this dispute.

V.

REASONS FOR GRANTING THE CONDITIONAL CROSS-PETITION IF CERTIORARI IS GRANTED IN CASE NO. 97-271

A. The Question Whether A Secured Loan Transaction Is A "Transfer" For Purposes Of Bankruptcy Code Section 549(a) Cannot Be Addressed Without Also Considering Whether Such A Transaction Is A "Transfer" For Purposes Of Bankruptcy Code Section 549(c).

Bankruptcy Code section 549(a) provides that a bankruptcy trustee or debtor in possession generally can avoid "a transfer of property of the estate" when such a transfer has not been authorized by the bankruptcy court. In Case No. 97-271, Cross-Respondent challenges the Ninth Circuit's holding that a secured loan transaction does not constitute a "transfer" for purposes of section 549. If Cross-Respondent were correct, however, it would also follow that a secured loan transaction constitutes a "transfer" for purposes of section 549(c), which provides a "good faith" defense to an avoidance action under section 549(a). *See Commissioner v. Lundy*, 116 S. Ct. 647, 655 (1996) (court must consider "[t]he interrelationship and close proximity of these provisions of a statute").

Section 549(c) provides that "the trustee may not avoid under [section 549(a)] a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value. . . . " As discussed further in Cross-Petitioners' Certiorari Opposition in Case No. 97-271, the Bankruptcy Court in this case found that Cross-Petitioners satisfied all of the requirements of section 549(c) but one when

they made their loan to the Debtors. Specifically, the Court found: (i) Cross-Petitioners acted in good faith, (ii) Cross-Petitioners had no knowledge of Debtors' chapter 11 case, and (iii) Cross-Petitioners provided value in the form of their loan.

The Bankruptcy Court nonetheless concluded that section 549(c) did not apply because, even though Cross-Petitioners had received a deed of trust, Cross-Petitioners had not received a "transfer of real property" as the Court interpreted that phrase. The Ninth Circuit did not reach this issue on appeal, because it determined that a loan transaction did not qualify as a "transfer" for purposes of *either* section 549(a) or 549(c).

This Court should not consider the applicability of section 549(a) without also considering the applicability of the section 549(c) defense. With respect to both section 549(a) and 549(c), the critical issue is the same – whether a secured loan transaction constitutes a "transfer" for purposes of that section.[3] Because identical words used in the same section generally have the same meaning, *see Gustafson v. Alloyd Co., Inc.*, 115 S. Ct. 1061, 1067 (1995), this Court should not consider the term "transfer" in

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[3] While section 549(c) also uses the term "purchaser", that term merely prevents the section from applying to involuntary transfers, which are not at issue in this case. A "purchaser" is nothing more than a "transferee of a voluntary transfer." 11 U.S.C. § 101(43). Were this Court to conclude that Cross-Petitioners' voluntary, secured loan is a "transfer" for purposes of section 549(c), then it would also have to conclude that Cross-Petitioners are "purchasers" for purposes of that section.

section 549(a) without also considering its use in section 549(c).

B. This Court Should Not Consider The Applicability Of Bankruptcy Code Section 549(a) Without Also Considering The Implications Of This Court's Decision In *Farrey v. Sanderfoot.*

As discussed more fully in Cross-Petitioners' Certiorari Opposition in Case No. 97-271, this Court's decision in *Farrey v. Sanderfoot* makes it clear that the bankruptcy avoidance powers apply only to acts that affect property that is already property of the debtor or its estate at the time of the act in question. *See* 500 U.S. at 296-98, 111 S. Ct. at 1828-30. This Court in *Farrey* recognized that a debtor could avoid the "fixing" of a lien that attached to the debtor's property *during the period in which the debtor had an interest in the property. Id.* By contrast, this Court also held that the debtor could not avoid a pre-existing lien that had attached before, or even contemporaneously with, the debtor's acquisition of the property. This Court reasoned that "[t]he statute does not say that the debtor may undo a lien on an interest in property." 500 U.S. at 296, 111 S. Ct. at 1829. Rather, the avoidance powers extend only to actions affecting property when such property already belongs to the debtor or its estate. *Id.*

Similarly, Cross-Petitioners' deed of trust in this case did not effectuate a transfer of estate property. Debtors did not own the Property until they completed the purchase using the proceeds from Cross-Petitioners' loan. At the time Cross-Petitioners recorded their deed of trust,

the Debtors had no pre-existing interest in the Property. Under California law, Cross-Petitioners' purchase money lien arose *simultaneously* with the Debtors' interest in the Property. *See* Certiorari Opposition at 23-24.

Because Debtors did not have an interest in the Property before Cross-Petitioners' lien attached, they cannot avoid the lien under section 549(a). *See Farrey*, 500 U.S. at 298, 111 S. Ct. at 1830 ("unless the debtor had the property interest to which the lien attached at some point before the lien attached to that interest, he or she cannot avoid the fixing of the lien").

C. This Court Should Not Consider The Applicability Of Section 549(a) Without Considering The Equitable Remedy Recognized By The Ninth Circuit In This Case.

Cross-Petitioners' Certiorari Opposition in Case No. 97-271 contains a comprehensive discussion of the legal and factual basis for the equitable remedy recognized by the Ninth Circuit below. As discussed more fully therein, for more than half a century the courts have recognized that, when a good faith lender advances money to a debtor without knowledge of the bankruptcy case, such a lender may be entitled to an equitable lien or other relief. *See* Certiorari Opposition at 9-13. Although the Ninth Circuit recognized Cross-Petitioners' equitable lien under Bankruptcy Code section 364, other courts have recognized equitable remedies under Bankruptcy Code section 549 as well. *See Sapir v. C.P.Q. Colorchrome Corp. (In re Photo Promotion Associates, Inc.)*, 881 F.2d 6, 8-9 (2d Cir.

1989) (holding that the courts have "broad discretion" in applying section 549).

The Ninth Circuit granted Cross-Petitioners an equitable lien in this case in recognition of the overwhelming equities in this case, including (i) Cross-Petitioners' good faith and lack of knowledge of the bankruptcy case; (ii) the benefits of the loan to Debtors' estate, including enabling Debtors to avoid forfeiting their $15,000 deposit; (iii) the fact that the Debtors made a profit on the Property, which Cross-Petitioners' loan had enabled Debtors to purchase; and (iv) the fact that Cross-Petitioners would likely receive no recovery whatsoever absent the equitable lien. This Court should not grant certiorari in this case without also considering the equitable considerations that compelled the result below.

VI.

CONCLUSION

The Petition for Certiorari in Case No. 97-271 should be denied. However, if the Petition in that case is granted, this Conditional Cross-Petition for Certiorari should also be granted so that this Court may consider fully all issues relating to the interpretation of Bankruptcy Code section

549 and the granting of an equitable lien under Bankruptcy Code section 364.

Respectfully submitted,

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